

**Exhibit H**

Form 5701	Department of the Treasury – Internal Revenue Service  NOTICE OF PROPOSED ADJUSTMENT
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.	Issue No.: 5701 - 114
Name and title of person to whom delivered: Joe Gibbs	Date: February 28, 2001

Entity for this proposed adjustment:  
Fresenius National Medical Care Holdings, Inc.

Based on the information we now have available and our discussions with you, we believe the proposed adjustment listed below should be included in the revenue agent's report. However, if you have additional information that would alter or reverse this proposal, please furnish this information as soon as possible.

Years	Amount	Serial Number & Description
12/31/1993	\$2,525,033	611 526-11, Research Credits
12/31/1994	\$2,875,927	526-11, Research Credits
12/31/1995	\$1,613,883	526-11, Research Credits
12/31/1996	\$0	526-11, Research Credits

Issue

See attached Form 886A

Reason for Proposed Adjustment

See attached Form 886A

Receipt of Form 5701 by Taxpayer: \_\_\_\_\_  
Signature \_\_\_\_\_ Date \_\_\_\_\_

Taxpayer Representative's action:  
 Agreed       Agreed in part       Disagreed  
 Have additional information; will submit by:

Case Manager: Fritz Vilma  
*James F. Fierle*      Date: 2/28/2001

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 1993 12 - 1996 12
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

Fresenius NMC Holdings	1993	1994	1995	1996	Total
Adjustment to Research Credits Decrease (Increase) in credit	\$2,525,033	\$2,875,927	\$1,613,883	\$0	\$7,014,843

### Issues

- A. Should the base period research expenses of Fresenius NMC Holdings be adjusted for consistency with taxpayer claims and IRS adjustments?
- B. Should the base period *research expenses* be adjusted for dispositions and acquisitions that occurred before or during the current credit year?
- C. Should the base period and historical *gross receipts* be adjusted for dispositions and acquisitions that occurred before or during the current credit year?
- D. What are the appropriate amounts for the I.R.C. section 41 research credits for Fresenius NMC Holdings for the years 1993 through 1996?

### Statement of Facts

The 1994 annual report for Fresenius NMC Holdings, then known as W.R. Grace & Co., describes the company as the world leader in specialty chemicals, and through their National Medical Care unit, a leading provider of kidney dialysis services. The other core business groups included packaging, container products, and construction products. While Fresenius' sales increased by 16% in 1994, their research and development spending decreased by 2%. The majority of their research was directed toward the core specialty chemical and health care businesses.

Form 886-A	<b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 - 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

A review of the information contained in Form 6765, Credit for Increasing Research Activities, showed that Fresenius is claiming the following amounts as research expenses and credits:

**FRESENIUS NMC HOLDINGS**  
**Research Expenses and Credits**

Year	Research Expenses Return Amount	Research Credits Return Amount
1993	\$74,677,973	\$4,479,830
1994	\$66,301,389	\$3,488,868
1995	\$43,499,641 <sup>1</sup>	\$2,827,477
1996	\$15,563,637 <sup>1</sup>	\$0

The Form 6765's are attached as Exhibit A.

Fresenius National Medical Care Holdings, Inc. was the surviving corporation in a September 29, 1996, merger with W.R. Grace & Company Affiliated Group. As a result of this merger, a former subsidiary of W.R. Grace & Company Affiliated Group, known as W.R. Grace & Co. - Conn., became a separate entity now known as W.R. Grace & Company and Subsidiaries (New Grace). The amounts listed in the table above are only for Fresenius NMC Holdings.

This Form 5701, Notice of Proposed Adjustments, relates only to the research credits claimed by Fresenius in their 1993 through 1996 tax returns. The research credits claimed by New Grace in their 1996 short year return are not included in these proposed adjustments.

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<sup>1</sup> The research expenses for 1995 and 1996 are for half years only, since the research credit was not available for the period July 1, 1995, through June 30, 1996.

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**Statement of Law****I.R.C. Section 41: CREDIT FOR INCREASING RESEARCH ACTIVITIES.****I.R.C. Section 174: RESEARCH AND EXPERIMENTAL EXPENDITURES.****I.R.C. Section 280C: CERTAIN EXPENSES FOR WHICH CREDITS ARE ALLOWABLE.**

Treasury Regulation section 1.41: Credit for Increasing Research Activities.

Treasury Regulation section 1.174: Research and Experimental Expenditures.

*Apple Computer, Inc. v. Commissioner, 98 T.C. 232.*

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**Taxpayer's Position**

The taxpayer's position is not known at this time.

**Engineer's Position**

I.R.C. section 41 provides for a tax credit for increasing research expenses. This credit is calculated as the excess of qualifying research expenses (as defined by the section) over a computed base amount. The base amount is equal to the fixed base percentage multiplied by the average of the historical gross receipts for the prior four years. The fixed base percentage is the percentage of qualified research expenses divided by gross receipts for the base years 1984 through 1988. This method of calculating the credit results in a research credit for a company as long as the company has spent a greater portion of their gross receipts on qualifying research than they spent during the 1984 to 1988 period.

When the taxpayer acquires a business, I.R.C. section 41(f)(3)(A) (covering acquisitions and dispositions) requires that the taxpayer's base period *research expenses* be increased by the amount of research expenses that had been paid by the seller during the period 1984 through 1988. Under most conditions, the taxpayer may also decrease their base period research expenses when they dispose of a portion of their business.

The section also requires that the *gross receipts* of the taxpayer for periods before the acquisition be increased by the gross receipts attributable to an acquired company, or decreased by the amount of gross receipts attributable to a sold portion of their business. Although this paragraph of the section deals with the acquisitions and dispositions of major portions of businesses that have qualified research expenses, the purpose of section 41(f)(3) is to provide for a consistent determination of the research credit. If the historical gross receipts were not adjusted for acquired and divested companies without research expenses, the effect of indexing the credit to the gross receipts would be undermined.

In the calculation of the research credits for their 1993 and 1994 tax returns, the taxpayer determined their fixed base percentage as approximately 0.98%. This figure was based on the aggregate research expenses of Fresenius for the years 1984 through 1988, divided by the aggregate gross receipts for the same period, as called for in the code section. However, there were no adjustments for the numerous acquisitions and dispositions that were made by the company during the period 1984 through 1995.

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The calculations for the 1993 year appear to include some downward adjustments to the *research expenses* for either the divested businesses or the IRS adjustments. The gross receipts are the actual amounts listed on the tax returns. (See Exhibit B for the base year gross receipts.)

**Fixed Base Percentage  
Per 1993 Return**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts</u>
8412	\$41,122,241	\$5,628,572,884
8512	\$46,123,223	\$6,088,608,263
8612	\$49,136,900	\$5,442,207,178
8712	\$49,768,827	\$3,372,854,704
8812	<u>\$54,555,976</u>	<u>\$4,011,107,220</u>
Total	\$240,707,167	\$24,543,350,249

1993 Fixed Base Percentage: .98%

The 1994 calculation of the base year *gross receipts* includes an increase due to the acquisition of National Medical Care in 1989. The research expenses are the unadjusted amounts from the tax returns (as shown in Exhibit C).

**Fixed Base Percentage  
Per 1994 Return**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts</u>
8412	\$45,407,591	\$5,981,820,118
8512	\$54,434,895	\$6,444,147,436
8612	\$53,752,600	\$5,909,446,710
8712	\$51,180,821	\$3,936,973,679
8812	<u>\$56,127,112</u>	<u>\$4,090,257,962</u>
Total	\$260,903,019	\$26,362,645,905

1994 Fixed Base Percentage: .99%

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In 1995, the fixed base percentage appears to have been recalculated to account for the changes in the company. However, the percentage was not used in the determination of any base amount for the 1995 year, resulting in the credit being calculated as a percentage of all of the research expenses, not just the increase. This can be seen on the Form 6765 for the 1995, included in Exhibit A.

The amount of research expenses, though, was correctly limited to only half of the research expenses for the year, since the research credit expired after June 30, 1995, and was not effective until after July 1, 1996. Similarly, only half of the average historical gross receipts for the four previous years, 1991 through 1994, were used in the calculation. (Exhibit D contains the schedules of historical gross receipts per return.) With the exception of the failure to subtract away the base amount, the 1995 calculation of the research credits appears correct.

**Fixed Base Percentage  
Per 1995 Return**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts</u>
8412	\$30,169,094	\$1,286,387,137
8512	\$39,536,148	\$1,372,293,190
8612	\$41,618,718	\$1,292,275,009
8712	\$41,521,686	\$1,415,194,306
8812	<u>\$44,968,971</u>	<u>\$1,554,708,969</u>
Total	\$197,814,617	\$6,920,858,611

Fixed Base Percentage: 2.86%

The preparation of the 1996 Form 6765, Credit for Increasing Research Expenses, addressed the changes to the base period gross receipts, the base period research expenses, and the historical gross receipts for the prior four years, that resulted from the acquisitions and dispositions occurring before or during the 1996 tax year for Fresenius. The calculation also was done for only half of the year, since the credit was not available for the time period between June 30, 1995 and July 1, 1996. Nevertheless, the fixed base percentage of 1.78% resulted in no research credits for Fresenius' 1996 year. No changes are being recommended to the 1996 research credit in this Notice of Proposed Adjustment.

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**Fixed Base Percentage  
Per 1996 Return**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts</u>
8412	\$35,212,740	\$2,051,978,492
8512	\$42,407,140	\$2,003,163,130
8612	\$46,203,655	\$2,213,365,928
8712	\$40,910,436	\$2,654,462,143
8812	<u>\$44,217,618</u>	<u>\$2,800,623,423</u>
Total	\$208,951,589	\$11,723,593,116

Fixed Base Percentage: 1.78%

The accurate determination of the research credits for Fresenius NMC Holdings depends upon the calculation of the base period research expenses, with changes for both acquisitions and dispositions and for prior IRS adjustments. The historical gross receipts also must be modified for any acquisitions or dispositions. This will allow for the correct determination of the fixed base percentage and the base amount in the calculation of Fresenius' research credit.

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A. Adjustment of Base Period *Research Expenses* for Consistency with Taxpayer Claims and IRS Adjustments.

The credit for increasing research activities depends upon a comparison of the amount of the taxpayer's current research expenses with a base amount, derived in part from the taxpayer's research expenses in the years 1984 through 1988 (more than ten years earlier for Fresenius' current tax years). For the credit to be applied only to the increase in expenditures, the type of expenditures that are either included or excluded must be the same for both the current years and base years.

Consistent treatment of expenses is now required under I.R.C. section 41(c)(4):

“Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expense for the credit year.”

Therefore, any types of expenses that are included in the current years' research expenses should also be included in the base year amounts if those activities occurred during the 1984 through 1988 years. Similarly, adjustments recommended by the I.R.S. to expenses in the base period years should also be applied to the calculation if those types of expenses are not present in the current years.

**Davison Increase**

In 1996, the taxpayer submitted a claim for additional research credits for the 1990, 1991 and 1992 years. The claim was based upon additional expenses that were identified as qualified research expenses but that had been omitted from the credit calculation for the tax returns. Although the claim was for years prior to the current cycle years, the study was intended to also benefit the taxpayer by allowing them to apply the conclusions to years after the claim period.

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The additional expenses presented in the claim were for the Cryovac, Research, and Davison Divisions. Although the research credit study did not include information about the amount of research expenses in the base years for the activities corresponding to those introduced in the claim, section 41 requires that the base years be adjusted for consistency.

This consistency adjustment for Cryovac and Research Division would have a minimal net effect. However, the net effect of changes made in the claim for Davison Division would not be minimal when carried back to the base period years. Since the type of expenses presented in the claim and accepted for Davison Division would be ongoing expenses included in the current years, the base period expenses should be increased for the calculation of the credit in the 1993 through 1995 years. (See Exhibit E, excerpt from Form 5701 – 172 for the 1990 to 1992 audit cycle.)

Davison's revised qualified research expenses in the claim were between 40% and 61% higher than the original return amounts. A similar 40% increase is recommended to the base period expenses:

**DAVISON DIVISION**  
**Increase in Base Period Expenses**

Year	Davison Division Research Expenses Per Return	Increase of 40% (Amount applied to Fresenius)	Revised Davison Expenses
1984	\$5,134,871	\$2,053,948	\$7,188,819
1985	\$5,879,369	\$2,351,748	\$8,231,117
1986	\$6,499,441	\$2,599,776	\$9,099,217
1987	\$5,904,981	\$2,361,992	\$8,266,973
1988	<u>\$6,184,093</u>	<u>\$2,473,637</u>	<u>\$8,657,730</u>
Total	\$29,602,755	\$11,841,102	\$41,443,856

In order to simplify the calculations, the increase to Davison's base period research expenses would be added to the accepted amount of Fresenius's base period research expenses.

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**I.R.S. Adjustments to Base Period Expenses**

In addition to the increase in the base period research expenses made to correspond with the conclusions of the taxpayer's 1996 research credit study and claim, other changes to the research expenses for the 1984 through 1988 years were recommended during the I.R.S. review of those years. (See Exhibit F for the excerpt from the 1987 - 1989 audit cycle engineering report.) Only those adjustments to the retained businesses are considered.

The only adjustment to the research expenses in the 1984 through 1986 audit cycle that was made to a remaining division of Fresenius was the change in Research Division's expenses in the following amounts:

	<u>1984</u>	<u>1985</u>	<u>1986</u>
Research Division	\$0	-\$140,464	-\$127,965

The recommended adjustments from the 1987 through 1989 audit cycle that affect the base year calculation for the current years were the changes to Dearborn Division and Research Division, and the exercised stock option amounts presented by the taxpayer (following the decision in *Apple Computer*).

	<u>1987</u>	<u>1988</u>
Dearborn Division	-\$435,170	-\$271,295
Research Division	-1,214,170	-\$1,446,296
<i>Apple Computer</i>	<u>+\$87,740</u>	<u>+\$24,597</u>
Total	\$1,561,600	\$1,692,994

Since the expenses disallowed by the I.R.S. and agreed to by the taxpayer should not be present in the research amounts for the current years 1993 through 1996, the base year expenses should be adjusted by these amounts.

<u>Acquisitions/ Dispositions</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Research Expenses	\$45,407,591	\$54,434,895	\$53,752,600	\$51,180,821	\$56,127,112
Per Return					
Davison Increase	+\$2,053,948	+\$2,351,748	+\$2,599,776	\$2,361,992	\$2,473,637
IRS Adjustments	<u>\$0</u>	<u>-\$140,464</u>	<u>-\$127,965</u>	<u>-\$1,561,600</u>	<u>-\$1,692,994</u>
Adjusted Research Exp.	\$47,461,539	\$56,646,179	\$56,224,411	\$51,981,213	\$56,907,755

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**B. Adjustment of Base Period *Research Expenses* for Acquisitions and Dispositions  
Occurring Before or During the Current Credit Year.**

The calculation of the base amount, for use in determining the increase in research expenses, changed for tax years beginning after 1989. Previously, the base amount was determined by taking the average of the research expenses for the three years prior to the current year. The base amount is now calculated as the fixed base percentage multiplied by the average annual gross receipts of the taxpayer for the four years preceding the current credit year. The fixed base percentage is calculated as the total research expenses of the taxpayer for the years 1984 through 1988 divided by the total gross receipts of the taxpayer for the same period.

I.R.C. section 41(f)(3) provides that, when a business changes hands, the qualified research expenses and gross receipts for periods prior to the change of ownership are treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of calculating the fixed-base percentage:

(A) **Acquisitions.** If, after December 31, 1983, a taxpayer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the "predecessor") or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section for any taxable year ending after such acquisition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such acquisition shall be increased by so much of such expenses paid or incurred by the predecessor with respect to the acquired trade or business as is attributable to the portion of such trade or business or separate unit acquired by the taxpayer, and the gross receipts of the taxpayer for such periods shall be increased by so much of the gross receipts of such predecessor with respect to the acquired trade or business as is attributable to such portion.

(B) **Dispositions.** If, after December 31, 1983-- (i) a taxpayer disposes of the major portion of any trade or business or the major portion of a separate unit of a trade or business in a transaction to which subparagraph (A) applies, and (ii) the taxpayer furnished the acquiring person such information as is necessary for the application of subparagraph (A), then, for purposes of applying this section for any taxable year ending after such disposition, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such disposition shall be decreased by so much of such expenses as is attributable to the portion of such trade or business or separate unit disposed of by the taxpayer, and the gross receipts of the taxpayer for such periods shall be decreased by so much of the gross receipts as is attributable to such portion.

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I.R.C. section 41(f)(3)(A), covering acquisitions, requires that the amount of the research expenses paid or incurred by the taxpayer during periods before the acquisition be increased by the amount of research expenses paid or incurred by the predecessor. It also requires that the gross receipts of the taxpayer for such periods be increased by the gross receipts attributable to the acquired company.

Increasing the taxpayer's base period research expenses for the research expenses of acquired companies results in a credit for only the increase in research expenses. Otherwise, the credit would be applied to the total amount of research expenses for the new business, since no base amount would be subtracted out through the fixed base percentage.

Similarly, decreasing the base amount research expenses by the expenses of disposed businesses results in a credit for actual increases in the research expenses. Failure to decrease the base period research expenses would reduce the credit: the current year expenses of the sold business would in effect be \$0, compared to a potentially significant amount of expenses in the base years. For example, what if Fresenius had sold their Research Division before their 1993 year? The taxpayer would get no benefit from the \$27 million or so of 1993 expenses, but would be penalized for the \$80 million in research expenses for the base period years 1984 through 1988.

However, section 41 only provides this relief for dispositions if the base period information is supplied to the acquiring company. There is no information to suggest that Fresenius withheld this information on the sale of these businesses.

Therefore, it is recommended that the base period research expenses be adjusted for the divested and acquired companies in Fresenius NMC Holdings' calculation of the research credit for the years 1993 through 1995.

During the period from 1984 through 1995, the taxpayer disposed of their interest in numerous businesses that had been conducting qualified research. Their one major acquisition, of National Medical Care and Subsidiaries, occurred in 1988, but had no research expenses transferred. The National Medical Care acquisition and the dispositions that occurred prior to 1990 were listed on a schedule provided by the taxpayer (see Exhibit G). Transactions happening in 1990 and after were identified through Form 851, Affiliation Schedule, and Form 8594, Asset Acquisition Statement. Also, in their work preparing the 1996 tax return, PriceWaterhouse-Coopers (PWC) made a schedule of dispositions and base period research expenses/gross receipts (see Exhibit H).

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A list of the acquisitions and dispositions with section 41 research expenses during the base years was completed by year of transaction, along with the actual research expenses from the tax return schedules (included as Exhibit C). The changes to the base year expenses to account for the acquisitions and dispositions are summarized below:

**Determination of Base Period Research Expenses  
1993 - 1995**

<u>Acquisitions/ Dispositions</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Research Expenses Per Return	\$45,407,591	\$54,434,895	\$53,752,600	\$51,180,821	\$56,127,112
Davison Increase	+\$2,053,948	+\$2,351,748	+\$2,599,776	\$2,361,992	\$2,473,637
IRS Adjustments	<u>\$0</u>	<u>-\$140,464</u>	<u>-\$127,965</u>	<u>-\$1,561,600</u>	<u>-\$1,692,994</u>
Adjusted Research Exp.	\$47,461,539	\$56,646,179	\$56,224,411	\$51,981,213	\$56,907,755
1986: 7 Dispositions	-\$2,387,540	-\$4,025,323	N/A	N/A	N/A
1987: 4 Dispositions	-\$337,157	-\$350,291	-\$89,424	N/A	N/A
1989: 1 Disposition	-\$110,308	-\$75,454	\$0	\$0	\$0
1992: 8 Dispositions	-\$7,384,022	-\$7,054,057	-\$8,261,901	-\$7,046,720	-\$8,451,507
1993: 3 Dispositions	<u>-\$293,228</u>	<u>-\$44,220</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Indicated Base Year Expenses for 1993	\$36,949,284	\$45,096,834	\$47,873,086	\$44,934,493	\$48,456,248
1994: 2 Dispositions	<u>-\$246,378</u>	<u>-\$2,873,018</u>	<u>-\$3,478,789</u>	<u>-\$3,912,164</u>	<u>-\$4,260,442</u>
Indicated Base Year Expenses for 1994	\$36,702,906	\$42,223,816	\$44,394,297	\$41,022,329	\$44,195,806
1995: No R&E Disposition	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
Indicated Base Year Expenses for 1995	\$36,702,906	\$42,223,816	\$44,394,297	\$41,022,329	\$44,195,806

The amount of research expenses for the divisions was determined from the attachments to the taxpayer's Forms 6765, Credit for Increasing Research Activities. The 1990 schedule of acquisitions and dispositions prepared by the taxpayer showed AgChem as a 1989 divestiture, but listed no amounts for the research expenses for that business. The above calculations reflect the decrease in the base year research expenses by the amount of AgChem's expenses per return.

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Also, the amounts from the tax return schedules differed from those listed on the PWC schedule for several dispositions, including the 1992 divestiture of E&C Polyfibron, Hampshire Chemicals and Walnut Grove, and the 1994 sale of American Breeders and Chomerics. The calculations herein rely upon the amounts reported on the return.

The detail of the recommended adjustments to the base period research expenses is included in Exhibit I.

Because dispositions occurred during the current years 1993 through 1995, the changes to the base year research expenses are different for different credit years. The base year research expenses, for the years 1984 through 1988, as adjusted for acquisitions and dispositions are as follows:

**Recommended Base Period Research Expenses  
1993 – 1995**

<u>Base Year</u>	<u>9312</u>	<u>9412</u>	<u>9512</u>
8412	\$36,949,284	\$36,702,906	\$36,702,906
8512	\$45,096,834	\$42,223,816	\$42,223,816
8612	\$47,873,086	\$44,394,297	\$44,394,297
8712	\$44,934,493	\$41,022,329	\$41,022,329
8812	\$48,456,248	\$44,195,806	\$44,195,806

The calculation of Fresenius' research credit should be modified to account for the dispositions that occurred before or during the current credit years.

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**C. Adjustment of Base Period and Historical *Gross Receipts* for Acquisitions and Dispositions Occurring Before or During the Current Credit Year.**

Just as the research expenses in the base years need to be adjusted for purchases and sales of companies, the gross receipts for the prior years should also be changed for acquisitions and dispositions. This preserves the method of the credit calculation: taxpayers receive a research credit when they spend a greater portion of their gross receipts on qualifying research than they had spent during the base period of 1984 through 1988.

The same code section 41(f)(3) requires this adjustment of base period gross receipts and the historical gross receipts of the prior four years for any acquisitions or dispositions occurring before the end of the taxable year.

All of Fresenius' acquisitions and dispositions that occurred before or during the current credit years should be considered in revising the base year and historical gross receipts, not just those businesses with qualified research activities. During the period from 1984 through 1995, there were many of these divestitures without research expenses, in addition to those taken into account above. The only acquisition was the 1988 purchase of National Medical Care.

The dispositions were again identified from the taxpayer's 1990 schedule of the revised credit calculations, from the Forms 851, Affiliation Schedule, and 8594, Asset Acquisition Statement, and from the 1996 schedule prepared by PWC. The amounts of the gross receipts for the various businesses were obtained from the Form 1120, page 1, consolidated schedules for both W.R. Grace & Co. Affiliated Group and W.R. Grace & Co. – Combining (included as Exhibits B and D).

The determination of the base period gross receipts is summarized in the following table.

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit: 5701 – 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 – 199612

Entity Name &amp; No.: Fresenius National Medical Care Holdings, Inc.

**Determination of Base Period Gross Receipts  
1993 – 1995  
(000s)**

<u>Acquisitions/ Dispositions</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Gross Receipts	\$5,628,572	\$6,088,608	\$5,442,207	\$3,372,854	\$4,011,107
Per Return					
1986: 17 Dispositions	-\$2,468,586	-\$3,012,556	-2,509,018	N/A	N/A
1987: 6 Dispositions	-\$113,050	-\$119,535	-\$119,686	-\$22,680	N/A
1988: 1 Disposition	-\$1,442	-\$1,441	-\$1,324	-1,000	-\$533
1988: NMC Acquisitions	+\$353,247	+\$355,539	+\$467,239	+\$564,118	+59,150
1989: 3 Disposition	-\$551,809	-\$517,008	-\$413,211	-\$497,113	-\$425,267
1992: 15 Dispositions	-\$603,804	-\$662,008	-\$748,700	-\$1,055,211	-\$1,138,103
1993: 13 Dispositions	<u>-\$478,148</u>	<u>-\$410,900</u>	<u>-\$245,763</u>	<u>-\$288,575</u>	<u>-\$322,357</u>
Indicated Gross Receipts for 1993	\$1,764,980	\$1,720,699	\$1,871,744	\$2,072,393	\$2,183,997
1994: 5 Dispositions	<u>-\$38,754</u>	<u>-\$49,196</u>	<u>-\$85,223</u>	<u>-\$137,553</u>	<u>-\$171,046</u>
Indicated Gross Receipts for 1994	\$1,726,226	\$1,671,503	\$1,786,521	\$1,934,840	\$2,012,951
1995: No Dispositions	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
Indicated Gross Receipts for 1995	\$1,726,226	\$1,671,503	\$1,786,521	\$1,934,840	\$2,012,951

**Determination of Historical Gross Receipts  
1993 – 1995  
(000s)**

<u>Acquisitions/ Dispositions</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Gross Receipts	\$4,017,115	\$4,340,437	\$4,234,141	\$3,809,010	\$3,566,771	\$3,684,495
Per Return						
1989: NMC Acquisitions	+\$5,794	N/A	N/A	N/A	N/A	N/A
1989: 3 Disposition	-\$119,199	N/A	N/A	N/A	N/A	N/A
1992: 15 Dispositions	-\$1,169,883	-\$1,224,472	-\$1,205,146	-\$641,916	N/A	N/A
1993: 13 Dispositions	<u>-\$364,890</u>	<u>-\$482,609</u>	<u>-\$478,264</u>	<u>-\$437,172</u>	<u>-\$119,083</u>	<u>N/A</u>
Indicated Gross Receipts for 1993	\$2,368,937	\$2,633,356	\$2,550,731	\$2,729,922	\$3,447,688	\$3,684,495
1994: 5 Dispositions	<u>-\$175,877</u>	<u>-\$207,590</u>	<u>-\$114,300</u>	<u>-\$116,973</u>	<u>-\$118,189</u>	<u>-\$75,897</u>
Indicated Gross Receipts for 1994	\$2,193,060	\$2,425,766	\$2,436,431	\$2,612,949	\$3,329,499	\$3,608,598
1995: No Dispositions	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>
Indicated Gross Receipts for 1995	\$2,193,060	\$2,425,766	\$2,436,431	\$2,612,949	\$3,329,499	\$3,608,598

Form 886-A	<b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit: 5701 – 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 – 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

There is only one difference between the numbers from the tax return statements and the 1990 taxpayer schedule of acquisitions and divestitures: the amounts for AgChem Division's gross receipts are \$37,864,000 lower for each of the years 1984 through 1989 than the receipts shown on the returns. The return amounts were used in determining the gross receipts summarized above.

Several differences exist between the tax return statements and the 1996 PWC's schedule: the 1992 sale of E&C Polyfibron, Polyfibron and Hampshire Chemicals, and the 1994 sale of American Breeders and Chomerics. These differences may arise from PWC's combining of a few divisions into one listing (Hampshire Chemicals) or from using the subsidiaries' profit and loss schedules. Again, the amounts used in this calculation were those shown on the tax return statements.

The detail of the recommended adjustments to the base period gross receipts is included in Exhibit J, and the recommended adjustments to the historical gross receipts in Exhibit K. It is recommended that the taxpayer's gross receipts be adjusted for the acquisitions and dispositions occurring before or during the credit year, to the following amounts:

**Recommended Base Year and Historical Gross Receipts**

1993 – 1995

(000s)

<b>Base Year</b>	<b>9312</b>	<b>9412</b>	<b>9512</b>
8412	\$1,764,980	\$1,726,226	\$1,726,226
8512	\$1,720,699	\$1,671,503	\$1,671,503
8612	\$1,871,744	\$1,786,521	\$1,786,521
8712	\$2,072,393	\$1,934,840	\$1,934,840
8812	\$2,183,997	\$2,012,951	\$2,012,951

**Historical Year**

8912	\$2,368,937		
9012	\$2,633,356	\$2,425,766	
9112	\$2,550,731	\$2,436,431	\$2,436,431
9212	\$2,729,922	\$2,612,949	\$2,612,949
9312		\$3,329,499	\$3,329,499
9412			\$3,608,598

Making these changes to the gross receipts for the base years and historical four years provides a true indication of the taxpayer's increase in research expenses for an accurate determination of the tax credit.

Form 886-A	<b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: <b>Fresenius National Medical Care Holdings, Inc.</b>		Year/Period Ended: <b>199312 - 199612</b>
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

D. Calculation of the recommended amounts of the I.R.C. section 41 research credits for Fresenius NMC Holdings for the years 1993 through 1996.

To determine the recommended research tax credit for Fresenius, the proposed fixed base percentage must first be calculated. Incorporating the changes from the taxpayer claim, the I.R.S. adjustments, and the dispositions of businesses, results in the following percentages:

**Recommended Fixed Base Percentage  
1993**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts (000s)</u>
8412	\$36,949,284	\$1,764,980
8512	\$45,096,834	\$1,720,699
8612	\$47,873,086	\$1,871,744
8712	\$44,934,493	\$2,072,393
8812	<u>\$48,456,248</u>	<u>\$2,183,997</u>
Total	\$223,309,945	\$9,613,813

1993 Fixed Base Percentage:                           2.32%

**Recommended Fixed Base Percentage  
1994**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts (000s)</u>
8412	\$36,702,906	\$1,726,226
8512	\$42,223,816	\$1,671,503
8612	\$44,394,297	\$1,786,521
8712	\$41,022,329	\$1,934,840
8812	<u>\$44,195,806</u>	<u>\$2,012,951</u>
Total	\$208,539,154	\$9,132,041

1994 Fixed Base Percentage:                           2.28%

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 - 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

**Recommended Fixed Base Percentage  
1995**

<u>Year</u>	<u>Research Expenses</u>	<u>Gross Receipts (000s)</u>
8412	\$36,702,906	\$1,726,226
8512	\$42,223,816	\$1,671,503
8612	\$44,394,297	\$1,786,521
8712	\$41,022,329	\$1,934,840
8812	<u>\$44,195,806</u>	<u>\$2,012,951</u>
Total	\$208,539,154	\$9,132,041

Fixed Base Percentage: 2.28%

The fixed base percentage is multiplied by the average of the prior four years' gross receipts, also adjusted for acquisitions and dispositions. Section 41 requires that the percentages shall be rounded to the nearest 1/100th of 1 percent in this calculation.

**Recommended Base Year and Historical Gross Receipts  
1993 – 1995  
(000s)**

<u>Historical Year</u>	<u>9312</u>	<u>9412</u>	<u>9512</u>
8912	\$2,368,937		
9012	\$2,633,356	\$2,425,766	
9112	\$2,550,731	\$2,436,431	\$2,436,431
9212	<u>\$2,729,922</u>	\$2,612,949	\$2,612,949
9312		<u>\$3,329,499</u>	\$3,329,499
9412			<u>\$3,608,598</u>
Total	\$10,282,946	\$10,804,645	\$11,987,477
Average	\$2,570,736	\$2,701,161	\$2,996,869

The calculation of the recommended research credit for Fresenius NMC Holdings is summarized on the following page.

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 - 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

**Fresenius NMC Holdings, Inc.  
Recommended Research Credits  
1993 - 1995**

	<u>9312</u>	<u>9412</u>	<u>9512</u>
Research Expenses Per Return	\$74,677,973	\$66,301,389	\$43,499,641
Fixed Base Percentage	2.32%	2.28%	2.28%
Average Historical Gross Receipts	\$2,570,735,763	\$2,701,160,316	\$2,996,868,803
50% of Avg. Gross Receipts	-----	-----	<u>\$1,498,434,402</u>
Indicated Base Amount	<u>-\$59,641,070</u>	<u>-\$61,586,455</u>	<u>-\$34,164,304</u>
Increase in Research Expenses	\$15,036,903	\$4,714,934	\$9,335,337
Research Credit (at 13%)	\$1,954,797	\$612,941	\$1,213,594

The average historical gross receipts for the four years prior to 1995 are divided in half to account for the research credit being available for only the second half of that tax year. Also, the actual tax credit is determined using a rate of 13% of the increase in research expenses over the base amount, as elected by the taxpayer under I.R.C. section 280C. No change is being recommended to the calculation of the 1996 research credit.

Form 886-A	EXPLANATION OF ITEMS	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 - 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

### Conclusion

After reviewing Fresenius' calculations of their research credits for the years 1993 through 1996, the changes in their approach were noted. In the 1993 and 1994 years, the actual, unadjusted research expenses and gross receipts were used in determining the fixed base percentage. The changes in the base year research expenses and gross receipts were addressed in the 1995 calculation, but a math error caused the credit to be overstated. The 1996 determination of the research credit took into account the base year adjustments and the 1996 merger and spin-off of the company, but no increase in the research expenses resulted for the year and no credit was taken.

Including the adjustments for the additional research expenses based upon the taxpayer's 1996 claim, the recommended I.R.S. adjustments for the base years 1984 through 1988, and accounting for the acquisitions and dispositions of the taxpayer's businesses, results in a change to Fresenius NMC Holdings' calculation of the research credit:

### FRESENIUS NMC HOLDINGS Research Credits

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>Total</u>
Research Credits per Return	\$4,479,830	\$3,488,868	\$2,827,477	\$0	\$10,796,175
Recommended Research Credits	<u>\$1,954,797</u>	<u>\$612,941</u>	<u>\$1,213,594</u>	<u>\$0</u>	<u>\$3,781,332</u>
Adjustment to Research Credits (Increase/(Decrease))	(\$2,525,033)	(\$2,875,927)	(\$1,613,883)	\$0	(\$7,014,843)

Form 886-A	<b>EXPLANATION OF ITEMS</b>	Schedule No. or Exhibit: 5701 - 114
Name of Taxpayer: Fresenius National Medical Care Holdings, Inc.		Year/Period Ended: 199312 - 199612
Entity Name & No.: Fresenius National Medical Care Holdings, Inc.		

## **EXHIBITS INDEX**

- EXHIBIT A** Form 6765's, Credit For Increasing Research Activities
- EXHIBIT B** Base Year Gross Receipts Per Return  
Consolidated Income and Expense Summaries
- EXHIBIT C** Base Year Research Expenses Per Return  
Research & Experimentation Credit Schedules
- EXHIBIT D** Historical Gross Receipts Per Return  
Consolidated Income and Expense Summaries
- EXHIBIT E** Excerpt from 1990 – 1992 Form 5701- 172  
Davison Division Increase
- EXHIBIT F** Excerpt from 1987 – 1989 Engineering Report  
I.R.S. Adjustments to Base Period Research Expenses
- EXHIBIT G** 1990 Tax Return Adjusted for IRS Audit  
Taxpayer's 1990 Schedule of Acquisitions and Divestitures
- EXHIBIT H** Rollforward of Base Period Qualifying Expenses and Gross Receipts  
PriceWaterhouse/Cooper's 1996 Schedule of Acquisitions and Dispositions
- EXHIBIT I** Recommended Base Year Expenses
- EXHIBIT J** Recommended Base Year Gross Receipts
- EXHIBIT K** Recommended Historical Gross Receipts